

Fiscal Note

BILL # HB 2702

TITLE: TPT; marketplace facilitators; nexus

SPONSOR: Toma

STATUS: As Amended by House WM

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Description

On June 21, 2018, the U.S. Supreme Court overruled in *South Dakota v. Wayfair Inc.* previous decisions made by the same court in 1967 (*National Bellas Hess, Inc. v. Illinois Department of Revenue*) and 1992 (*Quill Corp. v. North Dakota*), which both had held that only businesses with a physical presence inside a state can be required to collect that state's sales tax. If a business did not have nexus in the state, and therefore did not collect the tax, then the buyer was required to pay use tax instead.

HB 2702 includes several provisions addressing taxation in Arizona following the *Wayfair* ruling, including:

- Creating a new classification under the Transaction Privilege Tax (TPT) called "Marketplace Facilitator." A marketplace facilitator is a business that contracts with third-party sellers ("marketplace sellers") to facilitate the sale of their products on its marketplace platform.
- Establishing a nexus test for out-of-state businesses, under which a vendor or marketplace facilitator has nexus if it: (1) has gross proceeds exceeding \$100,000 from transactions in Arizona, or (2) engages in at least 200 separate transactions in Arizona. These thresholds are based on sales in the prior or current calendar year.
- Allowing cities, towns and other taxing jurisdictions to levy a sales tax on vendors or marketplace facilitators that have nexus in Arizona subject to certain requirements provided under the bill.

The bill would become effective on the first day of the month following the general effective date.

Estimated Impact

Based on our review of 2 different studies, which are described in the *Analysis* section below, we estimate that the bill could generate \$70 million to \$95 million annually in new state General Fund revenue by expanding the collection of TPT from more out-of-state vendors. Due to data constraints, however, these estimates are uncertain and should therefore be interpreted with caution.

The Department of Revenue (DOR) has not provided an estimate of the bill's impact.

As a fiscal note, our analysis does not address any legal issues concerning the bill.

Analysis

Estimate by the U.S. Government Accountability Office (GAO)

In November 2017, GAO released a study, which indicates a potential revenue gain from taxing remote sellers of between \$8.5 billion and \$13.4 billion. This estimate represents the potential revenue gain in 2017 for all state and local governments nationwide.

GAO prorated its national estimates to produce state-specific estimates, which showed that state and local governments combined could gain an estimated \$190 million to \$293 million in Arizona. Based on an average combined Arizona state and local sales tax rate of 8.25% in 2017 (as estimated by the Tax Foundation), these figures represent actual sales of \$2.30 billion to \$3.55 billion on which no sales taxes were collected.

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Taxing these sales at a rate of 5%, the state would have received \$115 million to \$178 million in total collections, of which \$85 million to \$131 million would have been retained by the General Fund.

The GAO study is comprehensive and includes several different data sources, including the Internet Retailer Top 1,000 Database, Forrester Research and the U.S. Census Bureau. GAO also provides a range of detailed estimates for both Business-to-Consumer (B2C) and Business-to-Business (B2B) remote sales. Due to a number of factors, we believe that the higher end of the GAO range may be overstated.

First, according to the GAO study, most of the potential revenue gain would not come from internet retailers and other remote sellers (such as mail-order companies and call centers) but from third-party sales facilitated by marketplaces. (Marketplace facilitators typically engage both in direct sales of their own products on their online marketplace as well as third-party sales on behalf of other vendors.) The authors of the study estimate that taxes on 78% to 86% of direct internet retail sales are already being collected compared to only 14% to 33% on third-party sales through marketplaces.

Table 1 below shows the potential state General Fund revenue gain by type of remote seller. These amounts are based on the prorating of GAO's national estimates by category of remote selling. GAO uses a low and high revenue scenario, which are also reflected in the table below. As displayed in *Table 1*, the prorating of GAO's national estimates indicates that the General Fund would potentially receive \$39.0 million to \$60.2 million from the taxation of marketplace sales.

The study's authors acknowledged that they had difficulties obtaining data on the extent to which marketplace facilitators, such as Amazon, Etsy, and eBay, currently collect and remit tax from their marketplace sellers. Considering the lack of data on sales tax collections from marketplace sellers and that so much of GAO's estimated revenue gain would come from such sales, we believe that this part of their analysis has the largest potential to overstate the actual impact.

Table 1		
Potential General Fund Revenue Gain from Taxing Remote Sellers		
Type of Remote Seller	General Fund Gain [Dollars in Millions]	
	Low	High
Business-to-Consumer (B2C):		
Internet Retailers	32.0	46.6
Marketplaces	39.0	60.2
Other Remote Sellers	15.0	17.5
Less Consumer Use Tax Compliance	<u>(2.0)</u>	<u>(1.9)</u>
B2C Total	84.0	122.3
Business-to-Business (B2B):		
B2B Sales Less Exemption for Intermediate Goods	10.0	28.2
Less Business Use Tax Compliance	<u>(9.0)</u>	<u>(19.4)</u>
B2B Total	1.0	8.7
Total Gain	\$85.0	\$131.0

A second reason to interpret GAO's figures cautiously is that their state-derived estimates, including Arizona's, were based on the prorating of national sales figures. Arizona's share of national B2C remote sales was based on the state's share of U.S. disposable personal income (1.8%) while the state's share of national B2B e-commerce and remote sales was based on Arizona's share of the U.S. gross domestic product (1.7%). Thus, to the extent that an out-of-state business' share of sales in Arizona relative to the nation differs from these assumed percentages, the GAO method will produce inaccurate estimates for the state. Therefore, a method based on the prorating of national estimates (as opposed to the use of state-specific data) has the effect of further increasing the uncertainty of the impact.

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Third, we have some indications that at least a few out-of-state businesses that did not collect state and local sales taxes in Arizona prior to the *Wayfair* ruling, are voluntarily doing so now. This suggests that insofar as these companies were included in GAO's estimates, the impact would be overstated. We are not able, however, to determine to what extent GAO's estimates would have to be adjusted for such changes following the *Wayfair* ruling.

Fourth, HB 2702 includes a remote seller exemption for out-of-state businesses with fewer than 200 transactions or less than \$100,000 in sales in Arizona. The GAO study was not adjusted for a small remote seller exemption. By itself, this factor would overstate their estimates slightly.

Fifth, some taxpayers (primarily businesses) that currently remit use tax to the state would pay TPT under the bill. Since the state receives 100% of the use tax but would only retain 73.8% under the new Marketplace Facilitator classification of TPT, there would be some offsetting General Fund revenue loss under the bill, which is not reflected in GAO's estimates.

Estimate by the League of Arizona Cities and Towns

The League estimates that the bill would generate \$46.1 million to \$82.3 million in state sales tax collections. After adjusting for state sales taxes shared with local governments, the JLBC Staff estimates that the General Fund would retain \$34.0 million to \$60.7 million.

To produce their estimate, the League used the Internet Retailer Top 1,000 Database, which reportedly account for more than 95% of the nation's e-commerce sales. (As noted earlier, GAO also used this data source along with several other data sources.) The League determined that 563 of the 1,000 remote sellers would be required to start collecting sales tax under the HB 2702. The League then used the national sales data reported for these companies to estimate the amount of sales taxes that would be collected in Arizona under the bill.

As with the GAO study, there were certain data limitations that likely affected the League's estimates. First, the League's estimates were based on the prorating of national data. Specifically, the League apportioned sales to Arizona based on the state's share of the U.S. population (2.16%). Second, the sales figures reported for the top 1,000 remote sellers were not exact figures but rather ranges (between a lower and upper bound), which could result in further forecast errors. Third, the League's analysis did not specifically address other forms of remote sales, such as marketplace sellers, mail orders, call centers, or B2B e-commerce. Such sales could be at least partially included in their estimates, however, since many of these companies also provide sales over the internet.

Local Government Impact

Counties

Under the bill, an estimated \$15 million to \$21 million would be distributed to counties as state-shared revenue. In terms of county excise taxes, including the transportation excise taxes levied by the Maricopa Association of Governments (MAG) and Pima Association of Governments (PAG), the bill would generate \$13 million to \$18 million annually.

Cities/Towns

Cities and towns would receive an estimated \$10 million to \$13 million in state-shared revenue. We have not attempted to estimate the impact on municipal taxes.

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